

11 U.S.C. § 1126(a)
Bankr. Rule 3017(e)
Standing

In re Shilo Inn, Diamond Bar, LLC, Case No. 302-32435

10/18/02 ELP

Published

Debtors sought an order determining procedures for voting by beneficial holders of trust indebtedness. Debtors are obligors on loans that are held by trusts. The trusts hold pools of loans, including debtors' loans, in which investors have certificates of interest. Debtors proposed a plan of reorganization and sought a determination that the certificate holders, not the servicer of the loans on behalf of the trusts, must vote the trusts' claims.

The court first held that a third party to the dispute did not have standing to provide argument and evidence, because the third party is not directly affected by a determination of who can vote the trusts' claims.

The court also held that the certificate holders do not have a right to vote the trusts' claims. The opinion discusses the difference between REMIC trusts and certificate holders, on the one hand, and indenture trustees and bond holders, on the other. The court concluded that the claims belong to the trusts, not to the individual certificate holders, and therefore the servicer of the loans could vote the claims on the trusts' behalf. The fact that the pooling and servicing agreements under which the servicer operates may require the servicer to vote against the plan does not mean that the certificate holders should instead be allowed to vote on the plan.

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UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF OREGON

In Re:)	Bankruptcy Case No.
)	
Shilo Inn, Diamond Bar, LLC,	)	302-32435-elp11 LEAD CASE
Shilo Inn, Oakhurst, LLC,	)	302-32436-elp11
Shilo Inn, Delano, LLC,	)	302-32437-elp11
Shilo Inn, Salt Lake City, LLC,	)	302-32438-elp11
Shilo Inn, Richland, LLC,	)	302-32681-elp11
Shilo Inn, Portland/205, LLC,	)	302-32682-elp11
Shilo Inn, Elko, LLC,	)	302-32982-elp11
Shilo Inn, Seaside Oceanfront, LLC,	)	302-32987-elp11
Shilo Inn, Spokane, LLC,	)	302-32988-elp11
Shilo Inn, Beaverton, LLC,	)	302-33026-elp11 through
Shilo Inn, Bend, LLC,	)	302-33043-elp11
Shilo Inn, Boise Riverside, LLC,)	
Shilo Inn, Casper, LLC,	)	(Jointly Administered under
Shilo Inn, Coeur d'Alene, LLC,	)	302-32435-elp11)
Shilo Inn, Grants Pass, LLC,)	
Shilo Inn, Idaho Falls, LLC,	)	MEMORANDUM OPINION
Shilo Inn, Lincoln City, LLC,)	
Shilo Inn, Nampa Blvd., LLC,)	
Shilo Inn, Nampa Suites, LLC,)	
Shilo Inn, Newport, LLC,)	
Shilo Inn, Salem, LLC,)	
Shilo Inn, Tacoma, LLC,)	
Shilo Inn, The Dalles, LLC,)	
Shilo Inn, Tillamook, LLC,)	
Shilo Inn, Warrenton, LLC,)	
Shilo Inn, Washington Square, LLC,)	
Shilo Inn, Yuma, LLC,)	
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Debtors.)	
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1 Debtors have filed a Motion for Order Determining Procedures
2 for Voting by Beneficial Holders of Trust Indebtedness. They seek,
3 pursuant to Bankruptcy Rule 3017(e),¹ to have the court determine
4 procedures for transmitting debtors' proposed plan, disclosure
5 statement and ballots to the holders of certificates of interest in
6 trusts holding loans that include loans to debtors. The issue is
7 whether the special servicer of the loan pools may vote the trusts'
8 claims, or whether those claims must be voted by the certificate
9 holders. For the reasons explained below, I conclude that the
10 special servicer may vote the claims, and therefore will deny the
11 motion.

12 FACTS

13 Debtors are 27 limited liability companies (LLCs), each of
14 which owns real property on which a Shilo Inn hotel is operated.
15 Prepetition, debtors obtained secured loans in an amount aggregating
16 approximately \$159,000,000. Those loans are now included in pools
17 of loans held in three trusts (Trusts 1-3). LaSalle Bank National
18 Association is the trustee for Trusts 1 and 2; State Street Bank and
19 Trust Company is the trustee for Trust 3. The trusts then sold the
20 beneficial interests in the pools of loans, including loans to
21 debtors and other entities, to investors who received certificates
22 evidencing their interests. The certificates are divided into
23 different classes, each of which has different rights with regard to
24

25 ¹ Unless otherwise indicated, all chapter, section and rule
26 references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1330, and to
the Federal Rules of Bankruptcy Procedure, Rules 1001-9036.

1 distributions from amounts collected on the pooled loans. This
2 arrangement has been referred to by the parties as "securitized
3 loans." Criimi Mae Services Limited Partnership (Criimi Mae) is the
4 special servicer for the pools of loans held by all three trusts.

5 Debtors listed their debts to the trusts in their bankruptcy
6 schedules. Criimi Mae asserts that, under the Pooling and Servicing
7 Agreements (PSAs) that govern its actions as special servicer, it is
8 entitled to vote on behalf of the trusts on debtors' proposed
9 chapter 11 plan of reorganization.² Debtors assert that provisions
10 of the PSAs restrict Criimi Mae's ability to vote in favor of the
11 plan, and therefore the beneficial holders of the trust indebtedness
12 must be able to vote on the plan.

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20 ² There are three PSAs for the loans on which debtors are
21 obligated, one PSA for each trust. At the trial in the adversary
22 proceeding Shilo Inn, Diamond Bar, LLC v. LaSalle Bank National
23 Assoc. et al., Adv. No. 02-3180 (Bankr. D. Or.), I admitted the
24 three PSAs into evidence as Exhibits 681, 682 and 683. The three
25 PSAs are substantially similar, although the specific section
26 references are not identical. Both parties refer to and rely on the
PSAs, therefore I will take judicial notice of them for purposes of
this motion. See Fed. R. Evid. 201. In deciding this motion, I
will primarily rely on and refer to Exhibit 681, which is the
December 1, 1997 PSA for Commercial Mortgage Pass-Through
Certificates Series 1997-ML1 (Trust 1).

DISCUSSION

1. Standing of Shilo Management Company

At the initial hearing on this motion, which was held at the same time as the disclosure statement hearing, I asked the parties to provide the court with further briefing with regard to the issues raised by the motion. Shilo Management Company (SMC) filed a letter and exhibits, providing argument and evidence for the position that the certificate holders are the appropriate parties to vote on debtors' plan.

The trusts object to my consideration of SMC's submissions, arguing that SMC is not a party to this motion and was not asked to provide briefing on the issues raised by the motion.

The parties to this motion are debtors and the trusts, represented by Criimi Mae. SMC is not a party.³ It has no direct stake in the outcome of the motion. In order to have standing, a person must be "aggrieved" by the bankruptcy court's action. See In re CFLC, Inc., 89 F.3d 673, 675 (9th Cir. 1996); In re Commercial Western Finance Corp., 761 F.2d 1329, 1334 (9th Cir. 1985); In re Fondiller, 707 F.2d 441, 442-43 (9th Cir. 1983). A person is aggrieved if the person is "directly and adversely affected pecuniarily by an order of the bankruptcy court." Fondiller, 707

³ Counsel for SMC appeared telephonically at the disclosure statement hearing. In response to a comment offered by counsel for SMC on this motion, I suggested that counsel might be able to assist debtors in preparing their brief. However, I did not ask SMC to submit its own brief and did not intend to give SMC standing to argue this motion.

1 F.2d at 442. The party asserting standing must show that the
2 bankruptcy court's order either diminishes its property, increases
3 its burdens, or detrimentally affects its rights. Fondiller, 707
4 F.2d at 442; In re Giordano, 212 B.R. 617 (9th Cir. BAP 1997).

5 SMC is a third party to the voting rights dispute. Its
6 interests will not be directly affected by a determination of
7 whether Criimi Mae or the certificate holders may vote the claims of
8 the trusts against debtors. Therefore, I will sustain the trusts'
9 objection and will not consider SMC's submissions.

10 2. Voting rights⁴

11 Bankruptcy Code § 1126(a) provides that "[t]he holder of a
12 claim or interest allowed under section 502 of this title may accept
13 or reject a plan." Claims are deemed allowed unless a party in
14 interest objects. § 502(a). In this case, the trusts filed proofs

15 ⁴ Debtors filed their motion pursuant to Rule 3017(e), which
16 allows the court to enter an order that "provides for transmission
17 of the plan and disclosure statement together with associated
18 materials to creditors, equity security holders and, in a chapter 11
19 case, the United States trustee." 9 Lawrence P. King, Collier on
20 Bankruptcy ¶ 3017.02[1] (15th ed. Rev. 2001). The trusts argue that
21 the rule does not apply because the creditors and equity security
22 holders to which the rule refers are creditors and equity holders of
23 the debtor, not creditors and equity security holders of creditors
24 of the debtor. Debtors do not claim that Rule 3017(e) applies if
25 the certificate holders are not entitled to vote on the plan; the
26 purpose of providing them with the plan and disclosure statement and
other associated materials is to inform their votes on the plan.
The issue distills to whether the certificate holders rather than
Criimi Mae are entitled to vote the trusts' claims. Debtors do not
dispute Criimi Mae's authority to act on behalf of the trusts; they
argue rather that the certificate holders are the proper entities to
vote the claims, not the trustees or an agent of the trustees.
Therefore, I will address the underlying issue of whether the
certificate holders are entitled to vote on the plan.

1 of claim in each case and no objections have been filed. Therefore,
2 pursuant to § 502(a), those claims are deemed allowed.

3 Only a holder of a claim may vote to accept or reject a plan.
4 Debtors argue that the certificate holders are the beneficial owners
5 of the loans to debtors, and therefore are the proper parties to
6 vote. They compare the relationship between the certificate holders
7 and the trusts to that between bondholders and an indenture trustee.
8 According to debtors, because bondholders are entitled to vote on a
9 plan in a reorganization of the entity that issued the bonds, the
10 certificate holders in this case should be able to vote on debtors'
11 proposed plan of reorganization. Debtors also argue that, as a
12 practical matter, the PSAs require Criimi Mae to oppose the plan on
13 behalf of the trusts.⁵ Because Criimi Mae is contractually bound to
14 vote to reject debtors' plan as proposed, debtors argue that the
15 certificate holders should be able to vote, because they are not
16 similarly constrained.

17 The trusts argue that indenture trustees and bond holders are
18 very different from REMIC⁶ trusts and certificate holders, and that
19 the trusts, not the certificate holders, hold the claims against

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21 ⁵ As I explain in more detail below, the PSAs limit Criimi
22 Mae's discretion in servicing and administering the loans. For
23 example, Criimi Mae as special servicer may not grant an extension
24 of the maturity of a loan for more than a year or modify a monetary
term of a mortgage loan, or accept substitute or additional
collateral, without the approval of the controlling class
representative. See Exh. 681 at § 3.27.

25 ⁶ The trusts in this case are real estate mortgage
26 investment conduits, or REMICs. See 26 U.S.C. § 860D (defining
REMIC).

1 debtors. They point to provisions in the PSAs that limit the rights
2 of certificate holders to control the actions of the special
3 servicer in its actions on behalf of the trust.

4 I conclude that the claims belong to the trusts, not to the
5 individual certificate holders, and therefore Criimi Mae as agent
6 for the trusts may vote the trusts' claims. First and foremost, the
7 certificate holders in this case hold certificates evidencing a
8 beneficial interest in the trust funds. The trust assets include
9 loans on which debtors are obligated. Debtors are not obligated to
10 the certificate holders. Likewise, the certificate holders do not
11 have any direct interest in the obligations of debtors. Their
12 interest is in the assets of the trusts. The trusts are creditors
13 of the Shilo Inn debtors.

14 Second, there are differences in structure between corporate
15 bond issuance and the securitization of assets that results in
16 issuance of certificates to investors.

17 Corporations, like other forms of business, frequently
18 raise capital through debt financing. Debt represents
19 borrowed capital which must be repaid. In essence, bonds or
20 debentures are promissory notes but contain more elaborate
21 provisions than ordinary commercial loans. . . . In order to
22 borrow funds from a large number of investors, corporations
23 and other public issuers contract with a third party to
24 administer a bond issue. This third party acts as the
25 indenture trustee.

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23 3 Thomas L. Hazen, The Law of Securities Regulation § 19.1 (4th ed.
24 2002)(footnote omitted). Thus, the holders of the bonds or
25 debentures are like holders of promissory notes evidencing debt of
26 the issuer corporation.

1 Where the issuer of corporate bonds becomes a debtor in
2 bankruptcy, Bankruptcy Rule 3003(c)(5) authorizes an indenture
3 trustee to file a proof of claim on behalf of all the bond holders.
4 However, "the indenture trustee is not the holder of the claim and,
5 accordingly, is not entitled to accept or reject a plan." 4 William
6 L. Norton, Jr., Norton Bankruptcy Law and Practice 2d § 91.19
7 (1997). The bond holders are entitled to vote their own claim or
8 interest. Lawrence P. King, Collier on Bankruptcy ¶ 1126.02[2]
9 (15th ed. Rev. 2001).

10 A securitization of assets is a different financing
11 structure.

12 A structured financing involving the issuance of asset-
13 backed securities is a hybrid transaction; it is a cross
14 between a traditional secured bank credit facility and a
15 securities offering. Rather than borrowing money directly
16 from a bank or issuing its own securities to investors, the
17 company causes a separate entity to issue securities backed
18 by the company's assets.

19 Although the details of structured financings vary
20 greatly, the fundamentals of most transactions are the same.
21 A company that generates receivables or loans (the originator
22 or originating company) transfers a pool of these assets to a
23 special purpose vehicle -- usually a corporation or a grantor
24 trust. The special purpose vehicle then issues securities,
25 either debt or equity, backed by the receivables or loans to
26 investors. The monies that the vehicle receives from the
investors are used by the special purpose vehicle to pay the
originator for the assets. The cash generated by the assets
is used to make principal and interest payments to the
investors.

23 Stephen I. Glover, "Structured Finance Goes Chapter 11: Asset
24 Securitization By Reorganization Companies," 47 Bus. Law. 611, 614
25 (Feb. 1992). In an asset securitization, then, the special purpose
26 vehicle, not the company that generates the receivables or loans,

1 issues the securities and has the relationship with the investors.
2 The investors' right to payment comes from cash generated by the
3 pooled assets, not from the general funds of the originator of the
4 assets.

5 That the certificate holders do not have direct rights
6 against the obligors on the pooled loans makes sense in light of the
7 complications that would arise if they had such rights. Asset pools
8 can contain a large number of assets. For example, the pool of
9 loans underlying Trust 3 (Mortgage Pass-Through Certificates Series
10 1996-C2) contains 300 loans, only four of which are debtors' loans.
11 Exhibit 683 at p. 208. Because it would be unwieldy for each of the
12 certificate holders to have individual rights against each of the
13 obligors on the 300 loans, the PSA provides the mechanism for
14 collection efforts, if needed, for the collective benefit of the
15 certificate holders.⁷

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17 Thus, in a corporate bond issuance, the investor is a
18 creditor of the corporation that issued the bonds or debentures, and
19 has a right to payment from the corporation. In contrast, in an
20 asset securitization, the investors' relationship is with the

22 ⁷ Also, as the trusts point out in their brief, the
23 different trust classes of certificate holders have widely disparate
24 economic interests and would likely vote to protect those interests.
25 Letter dated October 6, 2002 from Charles R. Gibbs at pp. 10-11. It
26 is not clear how votes of certificate holders of the various trust
classes would be calculated or weighed between trust classes in
determining the vote of the single bankruptcy plan class for each
mortgage.

1 special purpose vehicle to which the originator of the assets (here,
2 the banks that took the assignments of debtors' loans from the
3 original lenders) has transferred those assets, and the investors'
4 right to payment comes from the cash generated by the transferred
5 assets, not from the originator of the assets itself.

6 Finally, the PSAs in this case do not provide the certificate
7 holders a right to vote on the reorganization plan of obligors on
8 the loans that constitute the asset pool in which the certificate
9 holders hold an interest. The certificate holders have certain
10 limited voting rights, but only as specifically provided in the
11 PSAs. Exh. 681 at § 10.2. Those rights include the right to vote
12 to terminate the special servicer on default by the servicer, to
13 waive defaults by the servicer, to remove the trustee for the trust
14 and appoint a successor trustee, and to make certain limited
15 modifications to the PSA. Id. at §§ 7.1; 7.5; 8.7; 10.7. A
16 representative of the controlling class of certificate holders may
17 advise the special servicer with regard to certain actions, and the
18 special servicer may not take certain actions without the approval
19 of the controlling class representative, including modifying a term
20 of a mortgage loan other than the extension of the maturity date for
21 less than one year, and selling a defaulted loan or accepting
22 substitute or additional collateral for a mortgage loan. Id. at
23 § 3.27. The PSAs give the certificate holders rights to advise the
24 special servicer and to enforce their rights against the special
25 servicer and the trustee. However, they do not give the certificate
26 holders the right to enforce the pooled mortgage loans on their own

1 unless the trustee has been requested to do so and has refused. Id.
2 at § 10.2. That has not happened in this case; here, the trustee is
3 pursuing enforcement on behalf of the certificate holders. Thus,
4 the certificate holders do not have any rights to vote with regard
5 to any proposed modifications to the loans that are contained in
6 debtors' proposed plan of reorganization.

7 Debtors argue that the certificate holders must be allowed to
8 vote the trusts' claims because Criimi Mae as special servicer is
9 obligated under the PSAs to reject debtors' proposed plan. The PSAs
10 give Criimi Mae as special servicer broad authority "to do or cause
11 to be done any and all things in connection with such servicing and
12 administration of the Group 2 Mortgage Loans which they may deem
13 necessary or desirable," subject to certain servicing standards.
14 E.g., Exh. 681 at ¶ 3.2(a). The PSAs restrict that authority in
15 certain respects. For example, after a default in the payment of a
16 balloon payment on a Mortgage Loan, Criimi Mae is not permitted to
17 grant an extension that would extend the maturity date of the loan
18 beyond December 15, 2027. Id. at § 3.12(a). The special servicer
19 is allowed to waive due on sale clauses and to enter into assumption
20 agreements, but if it does so, it "shall not agree to modify, waive
21 or amend, and no assumption or substitution agreement entered into
22 pursuant to Section 3.11(a) shall contain any terms that are
23 different from, any term of any Group 2 Mortgage Loan or the related
24 Note or Mortgage." Id. at § 3.11(d). The special servicer can take
25 certain actions only if the controlling class representative has
26 approved such action in writing, including foreclosing on defaulted

1 mortgage loans, modifying a monetary term of the mortgage loan,
2 "other than a modification consisting of the extension of the
3 maturity date of such a Mortgage Loan for one year or less," selling
4 a defaulted mortgage loan, accepting substitute or additional
5 collateral for a mortgage loan, and waiving a due on sale clause or
6 accepting an assumption agreement releasing a borrower from
7 liability on a mortgage loan. Id. at § 3.27.

8 Even assuming that the restrictions contained in the PSAs
9 effectively preclude Criimi Mae from voting in favor of debtors'
10 proposed plan of reorganization, that fact does not lead to the
11 conclusion that the certificate holders must therefore be allowed to
12 vote the trusts' claims. The parties by contract have set out the
13 rights and obligations of Criimi Mae as special servicer. If the
14 parties agreed that the special servicer, as the representative of
15 the trusts' interests in the pooled assets, can not take certain
16 actions in connection with the reorganization of an obligor on some
17 of the assets in the pool, I know of no legal theory under which
18 that agreement should not be enforceable between the parties to the
19 PSAs. The agreement does not restrict Criimi Mae from voting on the
20 proposed plan; it merely restricts how Criimi Mae may cast that
21 vote. That is a circumstance debtors may take into consideration in
22 drafting their proposed plan. If debtors cannot, or choose not to,
23 propose a plan containing provisions within the limits of what
24 Criimi Mae may accept, the plan may nonetheless be confirmable
25 through "cramdown" under § 1129.

26 CONCLUSION

The certificate holders are not entitled to vote on debtors' proposed plan of reorganization. Therefore, there is no need to develop procedures for the transmission of the disclosure statement and plan to the certificate holders pursuant to Bankruptcy Rule 3017(e). I will deny debtors' motion. Counsel for the trusts should submit an order that denies the Motion for Order Determining Procedures for Voting by Beneficial Holders of Trust Indebtedness.

ELIZABETH L. PERRIS
Bankruptcy Judge

cc: Brad T. Summers
Charles R. Gibbs
K. C. McDaniel
Timothy J. Conway
Charles R. Markley
United States Trustee